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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1933

No. 728

SPRING CITY FOUNDRY COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR CERTIORARI FILED JANUARY 18, 1934.

CERTIORARI GRANTED MARCH 5, 1934.

SUPREME COURT OF THE UNITED STATES

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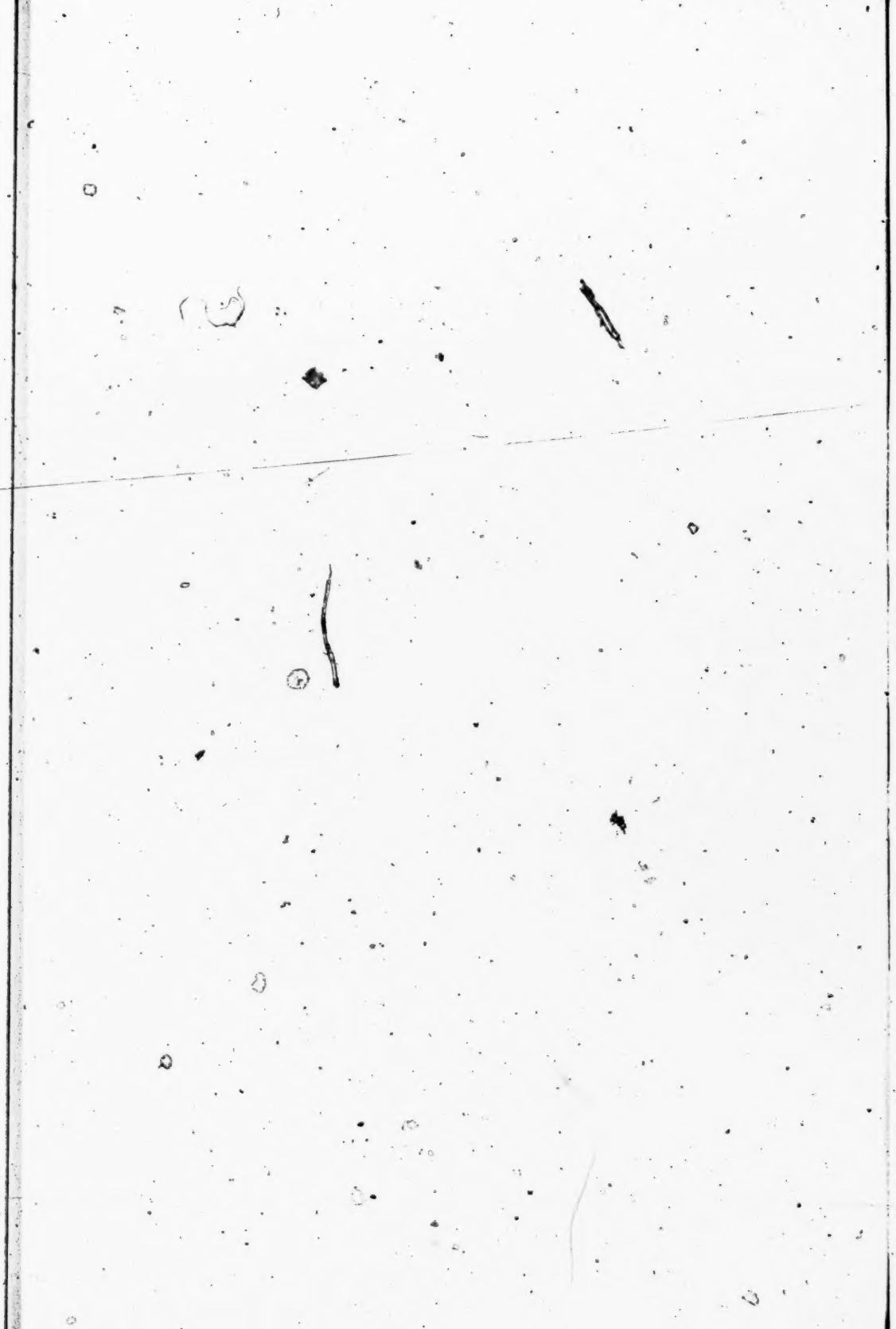

1 Spring City Foundry Co., *Petitioner,*
vs.
Commissioner of Internal Revenue, *Respondent.*
} Docket Number 21169.

For the Taxpayer: Edwar L. Wood, Richard H. Tyrrell, and H. C. Anderson, Esq.

For the Commissioner: E. C. Lake, L. A. Luce and John D. Kiley.

DOCKET ENTRIES.

1926

Nov. 9—Petition received and filed. Taxpayer notified.
Nov. 10—Copy of petition served on General Counsel.

1927

Jan. 10—Answer filed by G. C.
Feb. 2—Copy of answer served on taxpayer—Assigned General Calendar.

1929

Mar. 18—Notice of the appearance of Edwar L. Wood and Richard H. Tyrreel—in association with H. C. Anderson—attorneys for taxpayer.
Apr. 12—Hearing set June 5, 1929.
Apr. 16—Motion to transfer to the Chicago, Ill. Cir. Cal. filed by taxpayer 4/17/29 Granted.
May 23—Hearing set June 17, 1929—Chicago, Ill.
June 17—Hearing had before Mr. Siefkin on motion to continue to circuit calendar—granted. Notice of hearing sent to wrong address.
June 19—Order of continuance to Chicago, Ill. circuit calendar, entered.
June 24—Transcript of hearing of June 17-19, 1929 filed.

1930

Mar. 17—Hearing set Apr. 17, 1930, Chicago, Ill.
Apr. 1—Motion to confine hearing to issue defined in subdivisions (a) and (b) of Rule 62, filed by G. C. 4/7/30 Granted.
Apr. 17—Order of continuance to Apr. 25, 1930 entered.
Apr. 17—Hearing held before Miss Matthews, on motion. Continued to 4/25/30.

Apr. 24—Hearing had before Annabel Matthews—Div. 13—on the merits. Submitted—Briefs due June 25, 1930.

May 24—Motion for extension to July 10, 1930 to file brief, filed by G. C. 5/24/30 Granted.

June 2—Motion for extension to July 30, 1930, to file brief, filed by taxpayer, 6/2/30 Granted.

June 16—Transcript of hearing of April 17, 1930 filed.

June 16—Transcript of hearing of April 24, 1930 filed.

July 10—Motion for extension to July 30, 1930 to file brief, filed by G. C. 7/11/30 Granted.

July 22—Brief filed by taxpayer.

July 29—Brief filed by G. C.

2 1932

Mar. 10—Findings of fact and opinion rendered. Annabel Matthews—Div. 13—Judgment will be entered under Rule 50.

Apr. 15—Notice of settlement filed by G. C.

Apr. 19—Hearing set May 11, 1932, on settlement.

May 4—Consent to settlement filed by taxpayer.

May 13—Decision, entered. Annabel Matthews—Div. 13.

Aug. 19—Notice to send all notices to Richard H. Tyrrell, Esq., filed by H. C. Anderson.

Oct. 19—Petition for review by U. S. Cir. Ct. of Ap. 7th Cir. with assignments of error filed by G. C.

Oct. 25—Proof of service filed by G. C.

Nov. 4—Petition for review by U. S. Cir. Ct. of Ap. 7th Cir. with assignments of error filed by taxpayer.

Nov. 4—Proof of service filed by taxpayer.

Dec. 5—Motion for extension to Jan. 17, 1933 to file praecipe filed by G. C.

Dec. 13—Praecipe with proof of service thereon filed by G. C.

Dec. 5—Order enlarging time to June 17, 1933 to prepare and transmit record entered.

Dec. 19—Motion for extension to Feb. 2, 1933 to settle evidence to transmit record filed by taxpayer.

Dec. 19—Order enlarging time to Feb. 2, 1933 for preparation of evidence and delivery of record entered.

3 (Letterhead—Peat, Marwick, Mitchell & Co., Accountants and Auditors, Metropolitan Bank Building, Washington, D. C.)

November 4, 1926.

UNITED STATES BOARD OF TAX APPEALS.

Spring City Foundry Company,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
} Docket No. 21169.

PETITION.

Filed Nov. 9, 1926.

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, IT:E:SM: 60D-TCC, dated September 10, 1926, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at Waukesha, Wisconsin.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on September 10, 1926.

3. The taxes in controversy are income and profits taxes for the calendar year 1920 and for $19,848.08.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Evidences of debt received by the petitioner from the Cotta Transmission Company, Rockford, Illinois, in 1920 in exchange for merchandise sold to said Cotta Transmission Company in 1920, and outstanding at the close of 1920, in the nominal amount of $39,983.27, which were included in statutory net taxable income by the Commissioner of Internal Revenue, in his determination thereof, at their entire nominal value of $39,983.27, as accrued uncollected income for 1920, should not have been included by the Commissioner in taxable income for 1920 at their entire nominal value, as the Commissioner failed to recognize that such evidences of debt were not actual income to the petitioner in the amount of their nominal value; neither should they have been included by the Commissioner in taxable income at any value as the Commissioner failed to recognize that they were worthless and uncollectible at the close of 1920; or if the Commissioner was not in error in including them in taxable income, he was in error in denying the petitioner a deduction from taxable income, as computed by him, for bad debts

equal to the amount at which such evidences of debt may be included in taxable income.

(b) The petitioner's application to the Commissioner of Internal Revenue for the assessment of its excess profits tax for 1920 under the provisions of Sections 327 and 328 of the Revenue Act of 1918 was denied in error. (The application was denied on the alleged grounds that no abnormality in either capital or income had been established.)

5. The facts upon which this petitioner relies as the
5 basis of this proceeding are as follows:

(a) During a period from March, 1920, to September, 1920, inclusive, the petitioner sold castings to the Cotta Transmission Company for which it received evidences of debt, at first in the form of an open account, in the nominal amount of $40,302.07. Of this amount, $318.80 was paid or cancelled by cash remittances or credit memorandums, leaving a balance of $39,983.27. Unsecured notes in the amount of $32,290.00 were accepted during this period in exchange for open account in such amount, leaving a final open account of $7,693.27 and notes of $32,290.00. Each of the notes, with the exception of one for $9,300.00, was renewed one or more times prior to the end of September, 1920. The petitioner was an unsecured general creditor; both the notes and the open account were unsecured.

(b) The debtor was unable to pay its debts to the petitioner and so confessed to the petitioner. A meeting of the creditors, including the petitioner, was held in Chicago on October 6, 1920, and later meetings were held from time to time. A Creditor's Committee, including an officer of the petitioner thereon, was appointed on October 6, 1920, and took charge of the debtor's business. The Creditors' Committee thoroughly investigated the financial condition of the debtor, and, as a result of such investigation, abandoned all hope of continuing the business and so reported prior to November 5, 1920. The Committee made every possible effort to dispose of the debtor's property but failed to ever receive any bona fide offer, or offers, whatever. However,
6 on November 5, 1920, a group of Rockford citizens, hoping to save the debtor's industry to the City of Rockford, suggested a refinancing scheme to the Committee whereby the creditors were to surrender their claims for 40% of the face value thereof and such group was to raise the necessary funds for such purpose. The Committee gladly offered to acquiesce in such refinancing scheme and encouraged the group of Rockford citizens as much as possible,

realizing that it would be an extremely fortunate settlement for the creditors and that it was made only because the group of Rockford citizens was attempting to save the industry to the City of Rockford. However, the group of Rockford citizens was unable to raise the funds and abandoned the scheme. As the creditors, including the petitioner, were unable to obtain any offer or offers for the property, they filed an involuntary petition in bankruptcy against the debtor with the United States District Court at Freeport, Illinois, on December 23, 1920. That Court immediately appointed the Central Trust Company, Chicago, Illinois, as receivers, and on January 10, 1921, the debtor was duly adjudicated bankrupt, after which the Central Trust Company was appointed as Trustees.

(c) Immediately after their appointment, in December of 1920, the receivers made a thorough investigation of the possibility of selling the property and satisfied themselves that every possible effort had already been made by the Creditors' Committee to dispose of the property, and that the general conditions were such that a sale of the property would barely yield enough, if enough, to meet the priority claims and administration expenses. The debtor's plant was
7 offered for sale by the Court at frequent intervals from March 10, 1921, on, with absolutely no bids of any character being made for the property, until bids were received in connection with an offer for sale in December, 1921, although the offers for sale were extensively advertised. At the close of 1920, it was the opinion of the Manager of the Receivership Department of the Central Trust Company, who had active charge of the administration of the estate of the debtor, that a sale of the properties would realize little, if anything, more than enough to pay priority claims and costs of administration. This opinion was based upon the following existing conditions relative to the assets of the debtor's estate:

Accounts receivable not already assigned were almost entirely worthless, being worth approximately $2,000.00 only, without deduction for the cost of collection; the inventories consisted largely of special forgings, steels and dies for the manufacture of the debtor's transmissions and had only scrap value of an extremely minor amount because of their special nature; efforts made to dispose of the inventories to the original suppliers brought forth no bids of any kind; the real estate was located about a mile and a half from the heart of the business district of Rockford and could not be

sold for much more than enough, if enough, to meet priority claims and administrative expenses, as (1) there was absolutely no demand or offers for the property although every effort was made to obtain offers, (2) other properties were for sale or abandoned in the district; a large pump company whose plant occupied three city blocks, located near the heart of Rockford, was for sale; several other manufacturing plants had been closed up; and Emmerson-Brantingham Company, the largest industry in Rockford, was operating with only a very small force; and the other assets of the debtor, other
8 than cash and cash investments aggregating $1,639.73, were absolutely worthless, representing deferred charges to operations.

(d) The debt was excluded by the petitioner from its net income for 1920 on both its books and its tax return, by means of a charge off of the nominal value of the account under the caption of bad debts; on the grounds that it was worthless and uncollectible at the close of 1920, as indicated by the attendant and surrounding circumstances existing at that time.

(e) An abnormal condition affected the petitioner's capital or income for 1920, within the meaning of Section 327 of the Revenue Act of 1918, in that a large part of the capital employed in its business was borrowed and its statutory invested capital was abnormally low and disproportionate to the volume of sales and the statutory net income. The following is a statement of the Taxpayer's borrowings as at January 1, 1920, and as at the close of each month during 1920, showing separately borrowings on single name paper signed by the Taxpayer only and on discounted paper to the Waukesha National Bank, Waukesha, Wisconsin, by the Taxpayer and on which paper the Taxpayer was liable:

1920	Single Name Paper Stockholders	Bank	Two-Name (Discounted) Paper	Total
January 1	$5,000.00	19,000.00	48,859.00	72,859.00
January 31	5,000.00	19,000.00	51,815.97	75,815.97
February 28	5,000.00	19,000.00	71,756.01	95,756.01
March 31	5,000.00	19,000.00	91,280.00	115,280.00
April 30	5,000.00	19,000.00	101,441.45	125,441.45
May 31	2,500.00	19,000.00	98,741.45	120,241.45
June 30	2,500.00	19,000.00	100,429.84	121,929.84
July 31	2,500.00	19,000.00	127,916.59	149,416.59
August 31	.....	19,000.00	135,200.57	154,200.57
September 30	.....	19,000.00	118,772.39	137,772.39
October 31	.....	19,000.00	118,191.22	137,191.22
November 30	.....	28,300.00	64,647.52	92,947.52
December 31	.....	44,300.00	40,092.97	64,392.97
Average (Based on Monthly Balances)	$2,500.00	21,661.54	89,934.23	114,095.77

9 None of the two-name paper had bill of lading attached, or other documents evidencing any ownership of goods as the notes were only ordinary two-name promissory notes, nor was any of such notes without recourse to the petitioner.

(f) Should it for any reason be held that the aforementioned evidences of debt should be included in the petitioner's net income, after all allowable deductions, then an abnormal condition also affected the petitioner's capital or income for 1920, within the meaning of Section 327 of the Revenue Act of 1918, in that in the total statutory net income of $119,017.36, as determined by the Commissioner of Internal Revenue (the correctness of which determination is denied by the petitioner under subdivision (a) of paragraph 4 of this petition), there was included $39,983.27 as accrued uncollected income for 1920 in the form of evidences of debt, which amount was not actual income in fact and was known in 1920 to be not actual income in fact.

(g) The following is a statement of the petitioner's net sales, statutory net income, as now determined by the Commissioner, statutory invested capital, average borrowed capital based on monthly balances, and profits tax and income and profits taxes as now determined by the Commissioner, together with certain ratios relative to such figures, as undernoted, all of which figures and ratios are relative to the calendar year 1920:

Net Sales	$577,821.23
Statutory Net Income as now determined by Commissioner	119,017.86
Statutory Invested Capital	157,438.13
Average Borrowed Capital based on Monthly Balances	114,095.77
Profits Tax	38,190.41
Income and Profits Tax	46,073.11

10 Ratio of Statutory Net Income as now determined by Commissioner:

To Statutory Invested Capital	75.60
To Statutory Invested Capital Plus Average Borrowed Capital	43.83
To Net Sales	20.60
Ratio of Statutory Invested Capital to Net Sales	27.25
Ratio of Average Borrowed Capital to Statutory Invested Capital	72.47
Ratio of Profits Tax as now determined by Commissioner to Statutory Net Income as now determined by Commissioner	32.09
Ratio of Profits Tax as now determined by Commissioner to Statutory Net Income, as now determined by Commissioner, in excess of specific exemption of $3,000.00	32.92
Ratio of Income and Profits Taxes as now determined by Commissioner to Statutory Net Income as now determined by Commissioner	38.71

Wherefore the petitioner prays that this Board may hear the proceeding and order that the aforementioned evidences of debt received in 1920 shall not be included in the petitioner's taxable net income for 1920 at more than the actual value thereof, to the end that what is not actual income shall not be taxed as income; in accordance with the fundamental purpose of the income tax law, which purpose is to impose a tax upon net income, and that this Board may find that at the close of 1920 such evidences of debt were worthless and uncollectible, or of a more negligible value; and that this Board may order that the petitioner's excess profits tax for 1920 shall be computed in accordance with the provisions of Section 328 of the Revenue Act of 1918.

HAROLD C. ANDERSON,
Counsel for Petitioner
613—15th St., N. W.,
Washington, D. C.

State of Wisconsin } ss.
County of Waukesha }

H. E. BLAIR, being duly sworn, says that he is Pres. & Treasurer of the Spring City Foundry Company, above named, and is fully authorized to verify the foregoing petition; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

(Signed) H. E. BLAIR.

Subscribed and sworn to before me this 8 day of Nov., 1926.

(Signed) WALTER R. FRAME,
Notary Public.

EXHIBIT "A."

TREASURY DEPARTMENT

Washington

IT:E:SM:60D September 10, 1926.
TCC.
Spring City Foundry Company,
Waukesha, Wisconsin.

Sirs:

An audit of your income and profits tax return for the calendar year 1920 has resulted in the determination of a deficiency in tax of $19,848.08, as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition

and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenues. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM:60D:TCC. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. R. NASH
Assistant to the Commissioner

Enclosures:
Statement
Form A.

13 Statement.

IT:E:SM:60D
TCC

In re: Spring City Foundry Company,
Waukesha, Wisconsin.

Year	Deficiency in Tax
1920	$19,848.08

After a careful review of your protest dated May 26, 1926, against the denial of your application for the assessment of your profits tax for the calendar year 1920 under the provisions of Section 328 of the Revenue Act of 1918, as set forth in Bureau letter dated May 15, 1926, and of all the evidence submitted in support of your contentions, together with the facts presented by your representative at the conference held on July 27, 1926, the conclusion has been reached by the Bureau that no abnormality in either capital or income has been established as a fact.

Accordingly, the denial of your application for special assessment, of which you were advised in Bureau letter dated May 15, 1926, together with the deficiency in tax of $19,-

848.08, of which you were advised in Bureau letters dated March 18 and May 15, 1926, is sustained.

A copy of this communication has been furnished your authorized representatives, Peat, Marwick, Mitchell and Company, Metropolitan Bank Building, Washington, D. C.

14 (Caption)

ANSWER.

Filed Jan. 10, 1927.

The respondent, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of this taxpayer, filed November 9, 1926, admits and denies as follows:

1. Admits the statements and allegations contained in introductory paragraph and paragraph No. 1 of the petition filed herein.

2. Admits the allegations contained in paragraph No. 2 of the petition filed herein.

3. Admits the allegations contained in paragraph No. 3 of the petition filed herein.

4. Denies that the respondent erred in computing or determining petitioner's tax liability for the calendar year 1920 in either of the manners as alleged in corresponding paragraph of the petition filed herein.

5. The respondent admits and denies the allegations contained in corresponding paragraph of the petition filed herein as follows:

(a) Admits that during the period from March 1920 to September 1920, inclusive, the petitioner sold castings to the Cotta Transmission Company for which the latter Company agreed to pay $40,302.07, but denies that said Cotta
15 Transmission Company became insolvent during said year, or the petitioner determined said debt to be worthless prior to December 31, 1920, or charged said account off its books and denies all other allegations contained in corresponding subparagraph of the petition filed herein.

(b) Denies the allegations contained in corresponding subparagraph of the petition filed herein.

(c) Denies the allegations contained in corresponding subparagraph of the petition filed herein.

(d) Denies the allegations contained in corresponding subparagraph of the petition filed herein.

(e) Denies that abnormal conditions existed affecting the petitioner's capital or income for 1920 within the meaning of Section 327 of the Revenue Act of 1918, or that a large part of the petitioner's capital employed in the business was borrowed.

(f) Denies the correctness of the statements, arguments and conclusions contained in corresponding subparagraph of the petition filed herein.

(g) Denies the allegations contained in corresponding subparagraph of the petition filed herein and demands strict proof thereof.

16 Wherefore, it is prayed that upon final hearing of this appeal the petitioner's tax liability for 1920 be redetermined to be the sum $19,848.08.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
BRUCE A. LOW,
Special Attorney,
Bureau of Internal Revenue.

17 * * (Caption) * *

PROMULGATED MARCH 10, 1932.

Richard H. Tyrrell, Esq., for the petitioner.
L. A. Luce, Esq., for the respondent.

This proceeding arises upon a determination by the respondent of a deficiency of $19,848.08 in petitioner's income and profits taxes for the calendar year 1920. The petitioner assigns two errors: (1) respondent's refusal to allow the deduction of a certain debt amounting to $39,983.27, which petitioner alleges it ascertained to be worthless and charged off in the taxable year under section 234(a) of the Revenue Act of 1918; and (2) denial of petitioner's application to have its excess profits taxes for that year assessed under sections 327 and 328 on the ground of abnormality.

FINDINGS OF FACT.

The petitioner, a corporation with its principal office at Waukesha, Wisconsin, was engaged in the manufacture of gray iron automobile castings. It sold castings to the Cotta Transmission Company, a manufacturer of automobile truck

transmissions, of Rockford, Illinois, during the period from March, 1920, to September, 1920, inclusive, for which the latter company agreed to pay $40,302.07. Of this amount,
18 $318.80 was paid or cancelled by cash remittances or credit memoranda leaving a balance of $39,983.27. The petitioner was accustomed to accept from the debtor, the Cotta Company, its promissory notes and to discount them at the bank. Five notes were given by the Cotta Company to the petitioner in 1920 as follows:

1. Dated April 1, 1920, 90 days, 6%, $5,600.
2. Dated May 18, 1920, 90 days, $5,300.
3. Dated June 19, 1920, 90 days, 7%, $5,100.
4. Dated July 1920, 90 days, $9,300; discounted. When this note came due on October 13, 1920, and was not paid by the debtor, the petitioner gave its own note as maker on November 23, 1920, for 6 months, due May 21, 1921.
5. Dated August 16, 1920, 4 months, $6,990; discounted by petitioner with bank and paid by petitioner on December 21, 1920.

Three of these notes, for $5,600, $5,300, and $5,100, which had been renewed by the debtor from time to time, and had been discounted by petitioner with the bank, when falling due in December, 1920, were taken up by the petitioner which gave the bank a new note for $16,000 for 6 months, dated December 28, 1920. This note and the note for $9,300 given by the petitioner to the bank were ultimately paid by the petitioner. The total sum of the principal of the notes unpaid by the debtor and paid to the bank in cash by petitioner or by its note in 1920 was $32,390. The notes were unsecured.

The balance due on the petitioner's open account with the debtor at the close of December 1920, was $7,693.27. This
19 amount was unsecured. Neither the notes claim nor the open account was protected by insurance.

The amount of the Cotta Company's indebtedness to the petifioner, on notes and open account, $39,983.27, was charged on the petitioner's books on December 28, 1920, to "Profit and Loss," in compliance with the directions of the petitioner's president, Blair, to charge off the debt as bad, after Blair had conferred with the secretary and manager of petitioner, Reichl, on the matter and after examination of debtor's plant and assets, as will be more fully shown later.

The Cotta Company, finding itself in financial straits, in the latter part of 1920 requested of its principal creditors at a meeting on October 6, 1920, at Chicago, a five-year exten-

sion on all its accounts. This was refused. The creditors then appointed a creditors' committee to investigate the debtor's condition. The Eastern creditors met in Buffalo on the same day and the Rockford creditors met in Rockford on October 8. The petitioner was on the creditors' committee, which was to take charge of the debtor's business until December 15, 1920, a moratorium being declared in the interval. Shortly after the creditors' meeting of October 6, 1920, Blair, President and Treasurer of petitioner, together with Reichl, its Secretary and Manager, went to Rockford to look into the debtor's condition. With them were representatives of other creditors. They looked over the debtor's plant, conferred with various persons and decided to have an audit of the debtor's affairs made. The committee employed Arthur Young & Co., C. P. A.'s, to examine debtor's condition and report. The report was made on October 25 as of October 15, 1920.

The Young audit showed the debtor's cash and cash investments at $1,639.73; its accounts receivable at $126,107.92, of which, accounts in the amount of $63,108.02 were hypothecated to secure bank loans and overdrafts; inventories at $509,680.36, $446,849 thereof being finished or partly finished transmission parts; promotion and development expense, patent rights, etc., at $195,724.90; plant assets at $425,714.91; additional real estate at $14,947.16; the last three items constituting total fixed assets at $636,386.97; and total assets at $1,275,397.18. On the liability side the audit showed due to creditors, on open account, acceptances and notes, $593,513.81; due to banks on unsecured notes, $122,000, and on secured loans, $32,208.06; and due to officers and miscellaneous, $64,681.70 and $4,617.20, respectively, making total current liabilities, $817,020.77. There was a mortgage on land adjoining factory of $1,200.

The following comment was made on the balance sheet of the audit under the heading "inventories":

> From its cost records the Company had arrived at an estimate of inventory at August 31, 1920, but no later figure was available, owing to the abandonment of cost keeping after that date. The manner of handling the cost records makes it impossible at the present time to arrive at an accurate statement of inventory values without a physical inventory. In order, however, to present a complete statement for Balance Sheet purposes we made an estimate based on results of operations for the first eight

months of 1920, taking into consideration actual purchases of material, productive labor and overhead expense, the physical inventory valuation of January 1 and the book inventory of August 31. These figures indicated a cost of sales for the eight months of approximately 108 per cent; assuming a similar cost for the remaining 45 days to October 15, we arrived at an amount of $507,080.36 as the probable value of finished goods, work in
21 process, raw materials and scrap at the latter date. A physical inventory of the bar steel and scrap iron on hand (priced and extended by the company staff) indicated their value to be $54,456.14 and $5,775, respectively, the balance of $446,849.22 being set up as finished parts and work in process.

Promotion and Development Expenses, Etc. (Schedules II and III):

The items of engineering and advertising expenses prepaid are stated as they appear on the Company's books. Details of the manner in which these amounts were arrived at by the Company officials are shown in Schedules II and III. The valuation of patent rights is also the one shown by the books. We verified the amount of insurance premiums unexpired. The total value of fire insurance policies in effect at October 15, 1920 is $750,000, with additional amounts of $200,000 covering sprinkler leakage, use and occupancy, etc.

Plant Assets and Non-Operating Property (Schedule IV):

These items are stated at the values appearing in the books. We understand that these represent cost prices but have made no verification of this.

The audit took cost prices but made no attempt to verify them, relying entirely on book values. No allowance was made for obsolete parts. On the whole it was a hasty examination designed to show fully the liability and obligations of the company, but to report the assets at their face or going-concern value which was easily ascertainable and might be qualified as the individual creditors should see fit. The ordinary accounting method as to inventory, to take cost or market value, whichever is lower; and as to fixed assets, cost less depreciation, was not applied in the Young audit because of the assumption made as to a constant relation of value to

sale price regardless of possible decrease in value or obsolescence.

On November 4, 1920, certain Rockford citizens offered
22 the creditors' committee to purchase the debtor's plant and other assets at an amount equal to 33⅓ per cent of the creditors' claims, provided all the creditors should accept. On the creditors' declination of the offer, it was raised to 40 per cent, payable on or before December 15, 1920. Practically all the important creditors accepted, but the offerors found themselves unable to make the offer good by the agreed date, or within the week's extension allowed thereafter.

Three creditors, including the petitioner, then filed with the U. S. District Court for the Northern District of Illinois a petition in bankruptcy against the debtor, on December 23, 1920. On the following day the Central Trust Company of Illinois was appointed by the court receiver of the debtor in bankruptcy. On the 26th of December, Hummel, the manager of the receivership department of the receiver, went to Rockford and took possession of the bankrupt's property. He made his preliminary investigation in the first week of the receivership but continued to work on the debtor's affairs for over a year. He discussed its affairs with its creditors.

The schedule of the debtor's assets and debts filed with the court showed debts in the total amount of $815,278.65 and assets of $1,078,427.55. Listed under assets were bills, promissory notes and securities in the amount of $39,995.88, and debts due on open accounts totaling $100,290.80. These two amounts represent quick assets.

The debtor's inventories, as revealed by the receiver's investigation, consisted of parts for the manufacture of trans-
23 missions, castings and some steel, and although set up on debtor's books at $446,849 (as shown alos in the Young Audit made for the Creditors' Committee), had little more than scrap value except for the specific purpose for which they were made. Efforts made before the receivership to sell them to the suppliers of materials were unsuccessful, and subsequent efforts by the receiver to sell by advertisement also met with no success. The particular type of transmission made by the debtor was not perfect, and the company was constantly having to repair and make good the articles sold.

Of the debtor's accounts receivable, as shown in the balance sheet of the Young Audit, about half were pledged to banks. A large part of the remaining half was owed the debtor by firms which were also bankrupt; and on this ac-

count in December, 1920, the total unassigned accounts receivable of the debtor were then worth only about $2,000.

On January 20, 1921, the debtor was adjudged a bankrupt, and the Central Trust Co. became the trustee in bankruptcy.

No attempt was made by the receiver to sell the plant by advertising immediately after the adjudication in bankruptcy, owing to the market conditions, but a sale was advertised for March 8, 1921. No bids were received. Nothing further was done until September, 1921, when it was again advertised for sale. It was not sold, however, until some time in 1922, when it went to one Swartz, representing a Rockford syndicate, with all other assets except cash and accounts receivable, for about $175,000.

24 An attempt was made to collect the accounts receivable immediately after the receiver's appointment and was continued throughout the trusteeship.

The receiver operated the debtor's plant until November, 1921, filling repair orders for customers, in order to collect upon the accounts receivable. The plant during this period was never closed more than 2 weeks at a time. Only about 20 per cent of the old employees, exclusive of the salesmen who were all dismissed, were retained for the first 6 months when the employed personnel was increased somewhat. The plant was kept open by the receiver in order to obtain a better price for it, and by filling repair orders, ultimately to collect on old accounts receivable.

The motor-truck market in the fall of 1920 was very much depressed owing to various causes, but in part to the release at low prices of Government trucks made during the war. At this time the country was suffering from a general depression and its results were evident in Rockford. The debtor's plant was situated on the outskirts of Rockford. A number of other plants in Rockford, including a large pump plant, had been closed down before the debtor's receivership began, and the largest industry in the town was then operating on a very small scale.

In the spring of 1922, the receiver paid to creditors, including the petitioner, a dividend of 15 per cent of their claims. The petitioner received this payment on March 24, 1922, in the amount of $6,145.91. A second and final dividend of 12½ per cent was paid in 1923, the petitioner's share,

25 received on January 9, 1923, amounting to $5,121.60. These two dividends resulted from the sale of the debtor's plant and assets and the amount collected on its accounts receivable.

The debt owed by the Cotta Company to petitioner became partially worthless in 1920 and was ascertained to be so by the petitioner in that year.

The petitioner kept its books during the year 1920 and filed its income tax returns for that year on the accrual basis.

The petitioner claimed the full amount of the debt charged off on its books on December 28, 1920 as a deduction in its income tax return for 1920 and included as income in its returns for 1922 and 1923 the dividends received in the respective years from the trustee in bankruptcy. The respondent disallowed the full amount claimed as a deduction in 1920 but allowed petitioner a deduction from gross income in 1923 of $28,715.76, the difference between the full amount of the Cotta debt and the two dividends received by the petitioner.

For the year in controversy, 1920, the statutory net income of the petitioner, as determined by the respondent is $119,017.36, and its statutory invested capital $157,438.13. For the same year petitioner's profits tax is computed at $38,190.41 and its combined income and profits taxes at $46,073.11.

The average amount, based on monthly balances, which petitioner had borrowed on its own notes from stockholders and various banks and the amount which petitioner had
26 obtained by discounting, under its own endorsement, of debtor's papers, were as follows:

Own promissory notes to stockholders, $2,500; to banks, $21,661.54; by endorsement and discount, $89,934.23; grand total average a month $114,905.77. The notes discounted included those of the Cotta Company. None of the notes was endorsed by petitioner "without recourse". The expedient of discounting its debtor's paper was resorted to by petitioner in order to obtain the necessary cash to carry on its business.

Blair, President and Treasurer of petitioner, received as salary in 1920, $6,000, and then owned 400 shares of petitioner's stock; Reichl, as Secretary and Manager received $6,000, and owned 180 shares. Blair's wife held 30 shares and other shareholders 390. Blair had charge of credits and collections. Reichl's duties had to do with purchase of supplies and sales. He was also superintendent of the foundry and practical foundryman, in the absence of any general foreman.

The petitioner was never a party to a cost-plus contract with the Government.

OPINION.

MATTHEWS: 1. The first issue before us is whether the petitioner is entitled to any deduction for the year 1920 on account of the debt owed by the Cotta Transmission Company on its notes and open account in the total amount of $39,983.27. The respondent has allowed $28,715.76, the amount of the debt less the amount received by the petitioner as dividends from the debtor's trustee in bankruptcy, as a deduction in 1923.

The debt was charged off in its entirety on December 28, 1920 by the petitioner in good faith and in the belief that
27 little, if anything, would be paid by the receiver on its claim, and having charged off the entire amount in 1920, it returned as income in 1922 and 1923 the amounts received in those years as trustee's dividends.

The evidence in this case convinces us that the debt was not entirely worthless at the time of the charge-off on December 28, 1920. The citizens of Rockford had, on November 4, offered to purchase the plant and assets at 33⅓ per cent of the creditors' claims. This offer was declined and the citizens raised it to 40 per cent, payable on or before December 15, the time for payment being extended a week. They were not able, however, to raise the 40 per cent. The creditors then filed a petition in bankruptcy. The inability of the citizens of Rockford to raise the 440 per cent offer, which was accepted, raises doubt as to whether the same persons could have raised even the 33⅓ per cent offer which was rejected. The fact that the creditors filed a petition in bankruptcy at the expiration of the time, as extended, in which the 40 per cent was to be raised indicates that the creditors shared this doubt. It also indicates that they hoped to realize more through bankruptcy proceedings than the citizens of Rockford could pay. However, assuming that the creditors' claims were worth 33⅓ per cent of their face value at the time of the first offer, the effect of the taking over of the property of the debtor by the receiver was to reduce the amount which the creditors would ultimately receive, at least to the extent of the receivership costs. The amount ultimately received—27½ per cent—is strongly confirmatory of this conclusion. Taking all facts
28 into consideration as they existed at the time of the charge-off of the entire indebtedness, therefore, we think that a reasonable estimate of the cost of the receivership would have been at the least an amount equal to the difference

between the 33⅓ per cent and the 27½ per cent of the creditors' claims ultimately received. We conclude, therefore, that the debt was worthless to the extent of $28,715.76 at the time of the charge-off on December 28, 1920. As the debt was not wholly worthless when charged off, the question in controversy is whether the petitioner is entitled to any deduction within the taxable year.

Section 234(a) of the Revenue Act of 1918 provides that in computing the net income of a corporation

> * * * there shall be allowed as deductions:
>
> * * * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> (5) Debts ascertained to be worthless and charged off within the taxable year;
>
> * * * * * * *

The petitioner contends that if the whole debt is not deductible as such in 1920 it is still deductible as a loss under the doctrine of *Sherman & Bryan, Inc.*, v. *Commissioner*, 35 Fed. (2d) 713, and *Davidson Grocery Co.* v. *Commissioner*, 37 Fed. (2d) 806; that, while the cases cited allowed a deduction as a loss of that part of the debt which was never collected they did not so limit the rule; and that petitioner's loss was established by the turning over of the Cotta Company's business to the creditors in October, 1920, or in any event by the filing of the petition in bankruptcy and the appointment of the receiver in December, 1920.

29 As the debt was not wholly worthless in 1920, petitioner did not sustain a loss in that year equal to the total amount of the debt, and the *Sherman & Bryan* decision is not authority for the deduction of the full amount of the debt under such circumstances.

Petitioner further contends that the item of $39,983.27 never was income and should be eliminated from its gross income for 1920; that what is taxed is real and not supposed income. In support of this contention, petitioner quotes extensively from the opinion in *Corn Exchange Bank* v. *U. S.*, 37 Fed. (2d) 34, a case in which the question involved was whether interest accrued to December 31, 1918 on loans made by the Corn Exchange Bank to a company which went into receivership on December 31, 1918, and of which the taxpayer was advised on December 31, 1918, was required to be included in the return for 1918 as an item of accrued income. The court held that the item should not be treated as accrued

income. Petitioner argues that regardless of questions of deductibility the deficiency assessed must be set aside upon the ground that it is levied upon an item which never was income.

The item here in question represents the amount due petitioner for goods purchased by its debtor in 1920, and such amount includes the cost to petitioner of the goods sold as well as the expected profit on the sale. We think the cases are distinguishable on their facts.

Finally, petitioner submits that should the Board decide that the full amount of the debt is not deductible either as a bad debt or as a loss, and that the amount in question should not be excluded from gross income, it is entitled under the
30 decisions in *Sherman & Bryan, Inc.*, v. *Commissioner, supra*, and *Davidson Grocery Co.* v. *Commissioner, supra*, to a deduction from 1920 income of at least $28,715.76, the difference between the principal amount of the claim and the dividends received from the trustee in bankruptcy.

The Treasury interpretation of section 234 of the 1918 Revenue Act is that no deduction is allowable under that Act for a debt worthless only in part. Article 151, Regulations 45. This Board adopted the same construction in its earlier decisions, and it is urged upon us by the respondent's counsel that the matter is concluded by those decisions, citing *Steele Cotton Mill Co.*, 1 B. T. A. 229; *Murchison Bank*, 1 B. T. A. 617; *Toccoa Furniture Co.*, 12 B. T. A. 804; *Milwaukee Lumber Co.*, 17 B. T. A. 163, and *Minnehaha National Bank* v. *Commissioner*, 28 Fed. (2d) 763, (C. C. A. 8th).

All of the decisions cited by respondent were prior to the *Sherman & Bryan* decision and on their facts are distinguishable from *Sherman & Bryan*. In *Minnehaha National Bank* v. *Commissioner, supra*, notes either made or endorsed by an individual were written down because the bank officers believed they could not collect the entire amount of the notes. The individual was not in bankruptcy.

In the *Sherman* case the taxpayer, a corporation, was creditor of a motor truck company on an open account. The year involved was the petitioner's fiscal year ending September 20, 1920. In November, 1919, an equity receiver was appointed for the debtor company and the taxpayer filed its claim as a general creditor. No dividend was paid in the taxpayer's fiscal year 1920; and in that year the taxpayer, after in-
31 vestigation, charged off the debt as worthless. The Commissioner disallowed the deduction on the ground that the

debt was worthless only in part. A dividend, the amount of which was not shown in evidence, was paid in 1921. The instant case, therefore, appears to be on all fours with the *Sherman* case, so far as all material facts are concerned.

The Circuit Court held that the taxpayer's determination that the debt was wholly worthless in 1920 was not a reasonable conclusion of the taxpayer after an adequate investigation, on this point sustaining this Board's decision in the same case, 9 B. T. A. 213. With respect to the ascertainment of worthlessness, the Court said:

* * * * * * *

* * * While we have no doubt of the bona fides of Mr. Sherman's belief that the debt was worthless, we are not convinced that he had ascertained it to be worthless, within the meaning of the statute. To ascertain is to make sure by investigation, and it is conceded that to justify charging off a debt for tax purposes the taxpayer must make a reasonable investigation of the facts and draw a reasonable inference from the information thus obtainable. * * * While creditors are not required to be "incorrigible optimists", they may not be unduly pessimistic when claiming deductions for worthless debts. We are not satisfied that the petitioning taxpayer's determination that its debt was wholly worthless was a reasonable conclusion after adequate investigation. * * *

The other issue of law considered by the court in the *Sherman* case was the deductibility under the 1918 Act of so much of the debt as was proved worthless. The Government had contended that a debt worthless in part was not deductible under such Act and that such construction was supported by the fact that Congress, in the 1921 Act, permitted a deduction for a partial charge-off. The court pointed out that subsequent legislation was not conclusive that the construction
32 claimed for the earlier Act must be accepted and said that "debts ascertained to be worthless" might reasonably be construed to mean "indebtedness ascertained to be worthless" and to permit a charge-off of such part of a claim as was proven to be uncollectible by so definite an avent as seizure of the debtor's property by a receiver. The court held, however, that it was unnecessary to decide this point because "if clause (5) does not permit a deduction, we think it may be made under clause (4)". The Government urged that clauses (4) and (5) were mutually exclusive and that since clause (5) covered losses arising from worthless debts,

clause (4) must cover only losses otherwise arising. As to this contention, the court held that since the argument assumes that clause (5) does not permit the charge-off of a debt partially bad, there would seem to be no inconsistency in allowing the partial loss under clause (4), even if the two clauses were deemed mutually exclusive, pointing to the fact that it had not been authoritatively determined that they were mutually exclusive. After quoting from *U. S.* v. *S. S. White Dental Co.*, 274 U. S. 398, to the effect that the statute contemplated the deduction of losses "fixed by indentifiable events", and "in the case of debts, by the occurrence of such events as prevent their collection", the court said:

> The seizure of the debtor's property by a receiver prevents collection, and definitely fixes the loss to be the difference between the face of the debt and whatever dividend the receivership may pay. The Commissioner's position leads to the conclusion that, if any dividend is likely, no loss can be deducted until the receivership is wound up, which may be many years later. Business men do not carry on their books at face value claims against a debtor in receivership, and it cannot be supposed that
> 33 the Revenue Act of 1918 was intended to require them to do so. When a creditor's debtor goes into receivership, and the creditor believes the debt to be worthless and charges it off, he recognizes that he has sustained a loss at least to the extent that the receivership dividend which may thereafter be declared leaves the debt unpaid. Presumptively the taxpayer's decision that a debt is worthless, and so charged off, measures his loss. If the Commissioner surcharges his return because of a mistake as to the amount of the loss, we think he should not surcharge for so much of the loss as he admits has been suffered. No judicial decision has been found which contradicts this view.

The *Sherman* case was followed by the D. C. Court of Appeals in the *Davidson* case, that case presenting somewhat similar facts, the principal difference being the partial charge-off made by the taxpayer in the latter.

Although in terms the court allowed the deduction of so much of the debt as was determined to be worthless, as a loss, it made the basis of such allowance the ascertainment of worthlessness and the charging off which the statute requires in the case of bad debts, and made it clear that in its opinion the statute respecting the deduction of debts "ascertained to

be worthless'' did not prohibit the deduction of so much of the claim as was definitely determined to be worthless and charged off. The effect of the court's decision is to hold that the Revenue Act of 1918 permits a taxpayer to charge off that part of a claim against a debtor in receivership, which has been ascertained to be worthless. We agree with this construction and, further, think that the amount thus ascertained to be worthless and charged off in the taxable year is a loss deductible under (5) as a debt ascertained to be worthless and charged off.

34 A debt which becomes worthless in whole or in part is a loss to the extent of the worthlessness. Such a loss is deductible in the taxable year in which the debt is ascertained to be worthless and charged off. There is no provision in the statute under which such loss may be deducted in any other year than the one in which the ascertainment of worthlessness and charge-off occur. The statute makes the allowance of a deduction for worthless debts mandatory: ''* * * there shall be allowed as deductions, * * * debts ascertained to be worthless and charged off within the taxable year''. To hold that the language used applies only to those debts ascertained to be totally worthless and charged off and not to debts ascertained to be worthless in part and charged off, would result in a discrimination between creditors with wholly worthless debts and those with debts worthless only in part. As was said by the court in the *Sherman* case, business men do not carry on their books at face value claims against a debtor in receivership, when it is definitely known that the claims cannot be paid in full, and it can not be supposed that the Revenue Act of 1918 was intended to require them to do so until final liquidation of such claims in order to claim any deduction on account of such loss. The change in the Revenue Act of 1921 which allows the deduction of that part of a debt ascertained to be worthless and charged off may well indicate the unexpressed intention of the Revenue Act of 1918; that is to say, the new provision may well be regarded as declaratory of the meaning of the same provision of the 1918 Act. In this view of the matter, that part of

35 a debt which the creditor upon a reasonable investigation of all the facts determines to be worthless and charges off is a ''debt ascertained to be worthless and charged off'' within the meaning of the statute, and is deductible as such.

In the instant case, as in the *Sherman* case, the petitioner was unduly pessimistic in determining that the debt was to-

tally worthless. A reasonable inference from the facts available at the time of the charge-off justifies the inference that the debt was worthless at least to the extent of $28,715.76 and we think that this amount is deductible in the year 1920.

2. With respect to the second issue, we find, after a careful review of the facts and petitioner's arguments predicated upon them, no abnormality and therefore no proper basis for special assessment. The petitioner has not established that any ground for special relief exists by reason of its officers' salaries. The application rests, therefore, principally upon the petitioner's allegation that so large a part of the capital employed in its business was borrowed and its statutory invested capital consequently so low as to be disproportionate to the volume of its sales and statutory net income. It was shown that petitioner had an average borrowed capital, based on monthly balances, in 1920, of $114,095.77, and of this amount $89,934.23 constituted "two-name (discounted) paper." Blair, President and Treasurer of the petitioner, testified that the figures under this heading represented promissory notes made payable to the petitioner and given to it by its various debtors, which were discounted after indorsement by the petitioner at the bank.

36 This Board has held that the discounting of negotiable promissory notes does not constitute borrowing capital and is not a pledge of the notes for the amount so borrowed, but is in effect the sale of the notes to the indorsee: *American National Bank of St. Paul*, 14 B. T. A. 476. The Board stated its conclusion therein:

> From the cases and texts above cited, it seems to be well settled that to discount negotiable paper is to sell it. We have found no provision in the Reserve Banking Act which changes such generally accepted principle as to transactions between Federal Reserve Banks and member banks. It follows that petitioner sold its rediscounted paper to the Federal Reserve Bank and that such bank thereby became owner in exactly the same sense that petitioner owns the notes it discounts for its customers. The respondent's determination is approved.

If we deduct, then, the amount of discounted paper, we find that the petitioner's average borrowed capital in 1920 was approximately $24,000 or about 15 per cent of the statutory invested capital of $157,000, certainly not a sufficient amount to create an abnormal condition. In *Higginbotham-Bailey-*

Logan Co., supra, it was shown that 40 per cent of the petitioner's operating capital was borrowed, but the Board said:

> * * * In many businesses this would not be regarded as unusual or abnormal and in the absence of any evidence that it is abnormal in the wholesale dry goods business, there is nothing on which we may base an opinion as to normality or abnormality.

We do not find in the petitioner's situation any abnormality to justify the allowance of special assessment under section 327.

Reviewed by the Board.

JUDGMENT WILL BE ENTERED UNDER RULE 50.

STERNHAGEN dissents.

37 MURDOCK, *dissenting*: The prevailing opinion allows the petitioner to deduct in the year 1920 a portion of a debt owed to it by the Cotta Transmission Company. The Board has consistently held in at least twenty-three cases that under the Revenue Act of 1918 no deduction may be taken where a taxpayer ascertains that a debt is recoverable only in part. It has held that under that act there may be no deduction for a bad debt prior to the time that the taxpayer ascertains that the debt is wholly worthless. The Regulations of the Commissioner promulgated under revenue acts prior to the Revenue Act of 1921 have provided to the same effect. Decisions of the Board in which it has made such a ruling have been affirmed on appeal in at least three instances. See also *Selden* v. *Heiner*, 12 Fed. (2d) 474. In two instances such decisions of the Board have been reversed. One of the two cases in which the Board has been reversed on this question is *Sherman & Bryan* v. *Blair*, 35 Fed. (2d) 713. There the court did not decide the question whether partial worthlessness could be deducted under the Revenue Act of 1918, but held that in any event the amount could be deducted as a loss. I believe that the bad debt and loss provisions of the revenue acts are mutually exclusive even though I concede that in ordinary parlance a bad debt will be considered a loss. Cf. *Lafayette Lumber Company*, 20 B. T. A. 993. The other reversal was in *Davidson Grocery Company* v. *Lucas*, 37 Fed. (2d) 806, where the court approved of the reasoning in the *Sherman & Bryan* case. With all due respect to these courts, I find myself unable to agree with their reasoning and feel that until some more compelling reason appears, the Board should be consistent and follow its former

decisions. *Minnehaha National Bank* v. *Commissioner*, 28 Fed. (2d) 763. Cf. *Collin County National Bank* v. *Commissioner*, 48 Fed. (2d) 207.

LEECH, GOODRICH, MCMAHON, and VAN FOSSAN agree with this dissent.

38 (Caption) Entered M 13, 1932

DECISION.

Pursuant to findings of fact and opinion promulgated March 10, 1932, the respondent herein, to-wit, on April 15, 1932 having filed a proposed redetermination for the year 1920; and the petitioner on May 4, 1932, having filed notice of acquiescence to the said proposed redetermination, it is

Ordered and Decided that there is a deficiency for the year 1920 in the amount of $6,638.83.

Enter:

(Signed) ANNABEL MATTHEWS,
Member.

vlh

Entered May 13, 1932.

A True Copy Teste

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

(Seal)

43 (Caption) Filed Oct. 1932.

NOTICE OF FILING PETITION FOR REVIEW.

Filed Oct 25 1932.

To: Spring City Foundry Company,
Waukesha, Wisconsin.

To: Richard H. Tyrrell, Esq.,
Security Bldg.,
213 W. Wisconsin Avenue,
Milwaukee, Wisconsin.

You are hereby notified that the Commissioner of Internal Revenue did, on the 19th day of October, 1932, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 19th day of October, 1932.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 21 day of October, 1932.

WM. J. GRIDE,
(Seal) *President, Spring City Foundry Co.,*
Respondent on Review.
RICHARD H. TYRRELL,
(Seal) *Attorney for Respondent on Review.*

Oct. 19. 39 * * * (Caption) * * *

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR.

Filed Oct 19 1932

To the Honorable Judges of the United States Circuit Court of Appeals for the Seventh Circuit:

Now Comes David Burnet, Commissioner of Internal Revenue, by his attorneys, G. A. Youngquist, Assistant Attorney General, C. M. Charest, General Counsel, Bureau of Internal Revenue, and O. J. Tall, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

Jurisdiction

The petitioner on review (hereinafter referred to as the Commissioner) is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The respondent on review (hereinafter referred to as the taxpayer) is a corporation with principal office at Waukesha, Wisconsin, and filed its Federal income tax return for the calendar year 1920 at Milwaukee, Wisconsin, which is within the jurisdiction of the United States Circuit Court of Appeals for the Seventh Circuit.

40 II.

Nature of Controversy.

The Commissioner refused to allow as a deduction in computing taxable net income for the year 1920 any part of an amount of $39,983.27, which amount the taxpayer claimed as a bad debt arising from the sale of castings to the Cotta Transmission Company. The sales were made during the period from March, 1920, to September, 1920, inclusive. The taxpayer took notes from the debtor for all of the above amount except $7,693.27, which latter amount was unsecured. On December 28, 1920 the taxpayer charged the full amount of $39,983.27 to profit and loss. The Board found on the evidence that the debt was not entirely worthless in 1920 but concluded that it was partially worthless and allowed the taxpayer a deduction of $28,715.76.

III.

Assignments of Error.

The Commissioner says that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and decision rendered and entered by said Board manifest error occurred and intervened to the prejudice of the Commissioner, and the Commissioner assigns the following errors, and each of them, which, he avers, occurred in the said record, proceedings, opinions and decision and upon which he relies to reverse the said opinion and decision so rendered and entered by the United States Board of Tax Appeals, to wit:

1. The United States Board of Tax Appeals erred as a matter of law in holding that under the Revenue Act of 1918 the taxpayer is entitled to a bad debt which was ascertained during the taxable year to be worthless in part.

41 2. The United States Board of Tax Appeals erred as a matter of law in failing to hold that the taxpayer was not entitled to a deduction in computing taxable net income for a bad debt not ascertained to have become wholly worthless within the taxable year.

3. The United States Board of Tax Appeals erred in failing to find the deficiency for the year 1920 to be in the amount stated in the notice of deficiency, to wit, $19,848.08.

Wherefore, the Commissioner petitions that the decision

of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Seventh Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Signed) G. A. YOUNGQUIST,
Assistant Attorney General.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
O. J. TALL,
Special Attorney,
Bureau of Internal Revenue.

42 United States of America }
District of Columbia } ss.

C. M. CHAREST, being duly sworn, says that he is General Counsel of the Bureau of Internal Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

C. M. CHAREST.

Sworn and subscribed to before me this 18 day of Oct., 1932.

MARCELLETTE M. TAYLOR
(Seal) *Notary Public.*

My commission expires March 31, 1935.

Dec. 5. 46 (Caption)

ORDER ENLARGING TIME.

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to January 17, 1933.

(Signed) LOGAN MORRIS
(Seal) *Member.*

Dated: Washington, D. C.,
Dec. 5, 1932.
jd

44 (Caption)

PRAECIPE FOR RECORD.

Filed Dec. 13, 1932.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Seventh Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board.
(a) Petition, including annexed copy of deficiency letter.
(b) Answer.
3. Opinion of the Board.
4. Decision of the Board.
5. Petition for review, together with proof of service of filing petition for review and of service of a copy of petition for review.
6. This praecipe.

(Signed) C. M. CHAREST
General Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 10 day of December, 1932.

RICHARD H. TYRRELL.
Attorney for Respondent.

(Seal)

45 * * (Caption) * *

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 44, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 12th day of January, 1933.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

(Seal)

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit begun and held in the United States Court Room in the City of Chicago, in said Seventh Circuit on the fourth day of October, 1932, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Two, and of our Independence the One Hundred and Fifty-Seventh.

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

And on the twenty-first day of January, 1933, there was filed in the office of the Clerk of this court an appearance of counsel for respondent, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

The Clerk will enter our appearance as counsel for respondent.

Edgar L. Wood, Richard H. Tyrrell, 213 West Wisconsin Ave., Milwaukee, Wisconsin.

Endorsed: Filed January 21, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the twenty-third day of January, 1933, there was filed in the office of the Clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932

No. 4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

The Clerk will enter our appearance as counsel for the petitioner.

G. A. Youngquist, Sewall Key, Department of Justice, Washington, D. C.

Endorsed: Filed January 23, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the twentieth day of February, 1933, there was filed in the office of the Clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932

No. 4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

The Clerk will enter our appearances as counsel for the petitioner.

C. M. Charest, General Counsel, Bureau of Internal Revenue. Otis J. Tall, Special Attorney, Bureau of Internal Revenue.

Endorsed: Filed February 20, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the sixteenth day of March, 1933, there was filed in the office of the Clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1932

No. 4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

The Clerk will enter our appearance as counsel for the petitioner.

Sewall Key, Special Assistant to the Attorney General. William H. Riley, Jr., Special Assistant to the Attorney General. C. M. Charest, General Counsel, Bureau of Internal Revenue.

Endorsed: Filed March 16, 1933, Frederick G. Campbell, Clerk.

And afterwards, to-wit: On the tenth day of May, 1933, the following further proceedings were had and entered of record, to-wit:

Wednesday, May 10, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

4994

SPRING CITY FOUNDRY COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

It appearing that each of the parties to that certain proceeding before the United States Board of Tax Appeals

entitled Spring City Foundry Co., Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 21169, has appealed to this court and the appeal of the Commissioner of Internal Revenue has been perfected and is now pending herein, and it further appearing that the said United States Board of Tax Appeals has entered an order extending the time to April 15, 1933, for the transmission of the record of the tax payer Spring City Foundry Co.; and it appearing desirable that said appeals be consolidated for hearing and argument;

Now, therefore, upon reading and filing the annexed stipulation by counsel and upon motion of Edgar L. Wood and Richard H. Tyrrell, counsel for Spring City Foundry Co.,

It is ordered that said appeals be consolidated for hearing and argument.

It is further ordered that the brief of Spring City Foundry Co. as Respondent in the above entitled Cause No. 4912 may be served and filed at the time of filing and as a part of the brief of Spring City Foundry Co., as Petitioner in the cause on its appeal.

And afterwards, to-wit: On the twenty-fifth day of July, 1933, there was filed in the office of the Clerk of this court a motion for substitution of party petitioner, which said motion for substitution is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 4912

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

SPRING CITY FOUNDRY COMPANY, Respondent

MOTION FOR SUBSTITUTION

Comes now Guy T. Helvering, Commissioner of Internal Revenue, and moves the court that he be substituted for

David Burnet as petitioner herein, and in support of said motion respectfully shows:

1. That the resignation of said David Burnet, who was Commissioner of Internal Revenue when the petition for review in this proceeding was filed, was duly accepted and he ceased to be such officer on May 15, 1933.

2. That Guy T. Helvering was duly appointed and confirmed as Commissioner of Internal Revenue to succeed the said David Burnet; that he qualified as such officer and entered upon the duties of said office on June 6, 1933, since which date the said Guy T. Helvering has been and now is Commissioner of Internal Revenue.

3. That there is a substantial need for continuing and maintaining this proceeding and obtaining an adjudication of the questions involved, for otherwise the order of the United States Board of Tax Appeals herein sought to be reviewed will become final and the right to have the legality thereof determined will be extinguished.

This motion is made pursuant to the provisions of Section 11 of the Act of February 13, 1925, c. 229, 43 Stat. 941 (U. S. C., Title 28, Sec. 780).

Dated June 7, 1933.

Sewall Key, Special Assistant to the Attorney General, Attorney for Guy T. Helvering, Commissioner of Internal Revenue.

The undersigned attorney for respondent herein hereby expressly consents to the substitution sought by the above motion.

Richard H. Tyrrell, Attorney for Respondent.

Endorsed: Filed July 25, 1933, Frederick G. Campbell, Clerk.

And on the same day, to-wit: On the twenty-fifth day of July, 1933, the following further proceedings were had and entered of record, to-wit:

Tuesday, July 25, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

Upon motion of Guy T. Helvering, Commissioner of Internal Revenue, expressly consented to by the respondent, it is hereby ordered that said Guy T. Helvering, as such officer, be, and he hereby is substituted for David Burnet, former Commissioner of Internal Revenue, and that this proceeding be so continued and maintained.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States Court Room in the City of Chicago, in said Seventh Circuit on the third day of October, 1933, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Three and of our Independence the One Hundred and Fifty-Eighth.

Tuesday, October 3, 1933.

Court opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

It is ordered by the court that this cause be, and the same is hereby set down for hearing on October 19, 1933.

And afterwards, to-wit: On the nineteenth day of October, 1933, the following further proceedings were had and entered of record, to-wit:

Thursday, October 19, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

Now this day come the parties by their counsel and this cause now comes on to be heard on the printed record and briefs of counsel and on oral arguments by Mr. F. Edward Mitchell, counsel for petitioner, and by Mr. Richard H. Tyrrell, counsel for respondent, and the court having heard the same takes this matter under advisement.

And afterwards, to-wit: On the tenth day of November, 1933, there was filed in the office of the Clerk of this court the opinion of the court, which said opinion is not copied here as the same appears in the transcript of proceedings in this court, in Cause Number 4994—Spring City Foundry Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, certified herewith.

And on the same day, to-wit: On the tenth day of November, 1933, the following further proceedings were had and entered of record, to-wit:

Friday, November 10, 1933.

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the decision entered in this cause on May 13, 1932, by the United States Board of Tax Appeals be, and the same is hereby reversed; and that this cause be, and the same is hereby remanded to the said United States Board of Tax Appeals with directions to enter a decision in accordance with the views expressed in the opinion of this court.

And afterwards, to-wit: On the second day of December, 1933, there was filed in the office of the Clerk of this court an application for stay of mandate, which said stay of mandate is not copied here, as the same appears in the transcript of proceedings in Cause 4994—Spring City Foundry Company, Petitioner, vs. Commissioner of Internal Revenue, certified herewith.

And on the same day, to-wit: On the second day of December, 1933, the following further proceedings were had and entered of record, to-wit:

Saturday December 2, 1933.

Court met pursuant to adjournment.

Before Hon. Samuel Alschuler, Circuit Judge

4912

COMMISSIONER OF INTERNAL REVENUE

vs.

SPRING CITY FOUNDRY COMPANY

PETITION FOR REVIEW OF ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

Now this day comes counsel for the respondent and presents a motion for a stay of the mandate of this court, pending a petition to the Supreme Court of the United States for a writ of certiorari.

On consideration whereof: It is now here ordered that the mandate in this cause be, and the same is hereby stayed until the further order of this court.

It is further ordered that counsel for respondent proceed with diligence and promptly file the petition for a writ of certiorari in the Supreme Court of the United States and, upon the filing of said petition file in this court proof of the filing of said petition in said court.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten pages, numbered from 1 to 10, inclusive, contain a true copy of the proceedings had and papers filed (excepting the opinion of the court, filed November 10, 1933, and an application for stay of mandate, filed December 2, 1933, which are set out in full in the transcript of proceedings in this court in Cause 4994—Spring City Foundry Company vs. Commissioner of Internal Revenue, certified herewith; and briefs of counsel and stipulation and order relating to the filing of briefs), in the case of Commissioner of Internal Revenue, Petitioner, vs. Spring City Foundry Company, Respondent, No. 4912, October Term, 1932, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 5th day of December A. D. 1933.

Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit. (Seal United States Circuit Court of Appeals, Seventh Circuit.)

[fol. 43] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed March 5, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, limited to the question whether a debt ascertained to be partially worthless in 1920 was deductible in that year under either Section 234 (a) (4) or Section 234 (a) (5), and to the question whether the debt was returnable as taxable income in that year to the extent that it was then ascertained to be worthless.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.